6 Issues in Kleinbard, *The Right Tax at the Right Time*

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A new measure

PATAR: Tax Reform "Plan-to-American-Tax-Academic-Ratio."

Is PATAR $\geq$ 1? It sometimes seems so!

At least 3 instances are being discussed at this conference (Ed's Dual BEIT, DBCFT, Altshuler-Grubert).

Ed: "over-specifying a [tax reform plan] leads to reader fatigue or nitpicking, rather than admiration or adoption."

Mike Tyson: "Everyone has a plan until they get punched in the mouth."

Useful to disaggregate issues, despite Dual BEIT's integrated character – I'll pick just 6, for reasons of time.

1) Dual BEIT taxes normal returns

Whether to tax normal returns is a very familiar issue to this group!

Many (though not all) would agree w/ Ed on $0 < t_{\text{normal return}} < t_{\text{labor income}}$

By taxing normal returns at the owner level, rather than the entity level, Dual BEIT (a) improves targeting, (b) reduces avoidability, (c) makes feasible the application of graduated rates.

Ed's argument for a flat annual rate: (1) aids symmetrical treatment of risk, (2) administrative / political economy. But are there tradeoffs?

Flat rate isn't structurally indispensable – e.g., could have schedular treatment of COCA inclusions / other capital income.

2) Dual BEIT uses COCA, instead of expensing

Expensing obviates the need to define the normal rate of return, but …

Can't assume expensing gets it right without saying more about underlying purposes.

COCA increases policy flexibility if we might want to tailor & specify the returns that are exempted.

Kleinbard stands with Bradford re. the desirability of annual true-ups (requiring COCA), but they emphasize distinct rationales.

Bradford: TP anticipation of rate changes (or their unfairness under HE).
Kleinbard: emphasizes political economy issues (tax holidays, et al).

3) Dual BEIT exempts the normal return, not just the risk-free return

Ed's argument against using the risk-free return relies on incomplete markets.

E.g., firms can't borrow at it, or strip & sell tax receivables.

With incomplete markets, a TP's subjective valuation may differ as between items with the same market value (if can't swap them).

This may complicate the normative issues in multiple dimensions! Harder to gauge incentives or measure welfare if "sticky" items with the same market value differ in subjective value.

4) Dual BEIT's treatment of extra-normal returns

Once we've defined the relevant "normal" return & exempted it via the COCA deduction, multiple explanations for an observed higher return:

(a) It may reflect under-compensated labor income of owner-employees.

(b) It may reflect rents.

(c) It may reflect risk (higher expected *r*, actual ex post resolution).

Dual BEIT: (a) is identified via PCO rules (at least 50% owned by up to five 5% owners who materially participate) & taxed at higher rate;
(b) automatically faces the corporate rate;
(c) is treated close to neutrally (taxed at corporate rate when > *r*; losses (relative to *r*) -> interest-bearing NOLs.

4, cont: Why the PCO rules?

PCO rules come at the expense of "featurelessness." So why have them?

In principle, rents should be taxed **>** labor income, not at a lower rate.

So the best argument for the PCO rules **isn't** that labor income should be taxed at a higher rate than capital income.

Rather, it's that disguised labor income is easier than rents to tell apart from favorable risky outcomes.

3 further issues here. PCO rules:

(a) are more "lawyerish" than the rest & may invite tax planning responses;
(b) may not avoid discouraging risk-taking;
(c) may not be needed to avoid "unfairness" to later purchasers.

5) WW consolidation vs. DBCFT

Ed's international tax vision ≠ that of some others who are here today.

But many would agree that it's desirable (if sufficiently feasible) for the U.S. to tax rents from export sales of IP created in the U.S. (as Dual BEIT – but not the DBCFT – does).

E.g., Auerbach at NTA 2016 agreed that not doing this is a defect of the DBCFT (albeit, he said, not much of a retreat from the actual U.S. status quo).

Ed, for his part, agrees that it's non-ideal to tax-penalize U.S. corporate residence.

We're in the realm of tradeoffs here – not absolute principles.

6) Dual BEIT's allowing full foreign tax credits

Ed (unlike me) is fine with FTCs that might often cause the U.S. to collect zero observed revenue from imposing a WW tax on resident companies.

He notes that the minimum tax will also tend to be the maximum tax for corporate tax directors who don't want to get fired.

Indeed, he partly regrets concluding that we can't be more generous still by refunding excess FTCs (e.g., from source countries' not exempting the normal return).

One rationale for his view: the U.S. revenue effect isn't actually zero, given how resident companies would take advantage of territoriality.

But a full FTC ignores tradeoffs if we in the U.S. reasonably prefer that tax $$ be paid to us, rather than to other countries.